RSC
Republican Study Committee
Rep. Jeb Hensarling (R-TX), Chairman
Russ Vought, Executive Director
132 Cannon House Office Building
Washington, DC 20515
www.house.gov/hensarling/rsc
ph (202) 226-9717 / fax (202) 226-1633

Legislative Bulletin……………………………………….………October 4, 2007

Contents:

Summary of the Bill Under Consideration Today:

Total Number of New Government Programs: 0

Total Cost of Discretionary Authorizations: $0

Effect on Revenue: $34 million tax increase over ten years

Total Change in Mandatory Spending: $0

Total New State & Local Government Mandates: 0

Total New Private Sector Mandates: 1

Number of *Bills* Without Committee Reports: 0

Number of *Reported* Bills that Don't Cite Specific Clauses of Constitutional Authority: 0

H.R. 3648—Mortgage Forgiveness Debt Relief Act (*Rangel, D-NY*)

Order of Business: The bill is scheduled to be considered on Thursday, October 4th, subject to a closed rule (H.Res. 703) that self-executes (i.e. automatically passes) one amendment, yet allows no other amendments to be offered on the floor. See below for an RSC summary (which is different than the summary on the Rules website) of the self-executed amendment. The rule waives all points of order against the consideration of the bill (except those for earmarks and PAYGO), waives all points of order against the bill itself as modified by the self-executing amendment (except that for earmarks), and makes in order one motion to recommit (with or without instructions).

Background: Under current law, gross income for tax purposes includes income that is realized by a debtor from the discharge of that indebtedness, subject to certain exceptions (such as bankruptcy). For example, if a taxpayer owns a home subject to a $350,000 mortgage debt, and if the creditor forecloses and sells the home for $300,000 in satisfaction of the debt, the taxpayer has $50,000 income from the discharge of indebtedness that is includible in gross income.

Summary: H.R. 3648 would make a variety of changes to the tax laws regarding residential property. The specifics of the legislation are as follows:

DISCHARGING OF MORTGAGE DEBT
Saves taxpayers $885 million over five years and $1.4 billion over ten years

- Excludes from the gross income of a taxpayer (beginning on January 1, 2007) any discharge of indebtedness income, as long as the debt is for the acquisition, construction, or substantial improvement of the taxpayer's principal home (in addition to certain refinancing).

- Applies this tax exclusion, if only a portion of a discharged debt qualifies, only to so much of the amount discharged as exceeds the portion of the debt which does not qualify. For example, if a taxpayer has $900,000 in debt on a home, of which $800,000 qualifies as debt under this bill, and the residence is sold for $650,000 (thereby discharging $250,000 in debt), then only $150,000 of the amount discharged may be excluded from gross income under this legislation ($250,000 minus the difference between $900,000 and $800,000).

- Sets no cap on the indebtedness or the tax exclusion in this legislation, and does not sunset the exclusion.

- Reduces the cost basis of the individual's principal residence by the amount excluded from income under this legislation.

- Prohibits the tax exclusion from applying to the discharge of debt if the discharge is on account of services performed for the lender.

MORTGAGE INSURANCE
Saves taxpayers $536 million over five years and $570 million over ten years

- Extends through December 31, 2014 the current-law exclusion of mortgage insurance premiums from gross income for tax purposes.

COOPERATIVE HOUSING CORPORATIONS
Saves taxpayers $9 million over five years and $22 million over ten years

- Makes it easier for residents in a "co-op" to deduct their proportionate share of the co-op's real estate taxes and mortgage interest by offering three tests, only one of which must apply to trigger the deductibility:

--1) At least 80% of the co-op's gross income for that taxable year is derived from residents ("tenant-stockholders");
--2) At all times during that taxable year, at least 80% of the total square footage of the co-op's property is used or available for use by the tenant-stockholders for residential purposes or purposes ancillary to such residential use; or
--3) At least 90% of the co-op's expenditures paid or incurred during that taxable year are paid or incurred for the acquisition, construction, management, maintenance, or care of the co-op's property for the benefit of tenant-stockholders.

- Under current law, only the first test is available and has reportedly caused hardships for co-ops that have considerable commercial space on its property.

LIMITING OF CAPITAL GAIN EXCLUSION
Costs taxpayers $497 million over five years and $2.0 billion over ten years

- Prohibits a taxpayer from excluding from gross income the full capital gain realized on the sale or exchange of a secondary residence. Under current law, a taxpayer may exclude up to $250,000 ($500,000 if married filing a joint return) of gain realized on the sale or exchange of a principal residence. To be eligible for the exclusion, the taxpayer must have owned and used the residence as a principal residence for any 24 of the 60 months immediately preceding the sale or exchange.

- Under H.R. 3648, beginning in 2008, the amount of such capital gain on a residence that is excluded from gross income would be reduced by the amount of gain multiplied by the following fraction: the total time that the taxpayer (or the taxpayer's spouse or former spouse) owned the property yet did not use it as a primary residence divided by the period the taxpayer owned the property. For example, if a taxpayer realized a $100,000 capital gain on the sale of a beach house but only used it as a principal residence for two of the ten years she owned it, her excludable gain from gross income would be reduced by $80,000 ($100,000 times the fraction: eight years over ten years).

- NOTE: For purposes of this formula above, years of ownership prior to 2008—regardless of whether the property was occupied or not—are counted as though it was used as a primary residence. Further, the exclusion from gross income is only available if the property was a primary residence for at least two of the five years leading up to the sale.

- Makes exceptions (i.e. does not apply the reduced gain exclusion) for any period after the last date the property is used as the principal residence of the taxpayer or spouse (regardless of use during that period); service in the military, Foreign Service, or the intelligence community; and any period up to two years that the taxpayer is temporarily absent by reason of a change in place of employment, health, or, to a certain extent, unforeseen circumstances.

TIMING SHIFT OF CORPORATE TAX PAYMENTS
Increases revenues by $1.1 billion over five years but has no net effect over ten years

- Increases the estimated tax payments that certain corporations must remit to the federal government. Under current law, corporations with assets of at least $1 billion must make estimated tax payments for the third quarter of 2012 that are 114.75% of the estimated payment otherwise due. The payment due for the fourth quarter of 2012 is reduced accordingly so that the corporations pay no net increase in estimated payments in 2012.

- H.R. 3648 would increase this 114.75% figure to 116.75%. This provision is merely a revenue timing shift, a gimmick used to comply with the House's PAYGO rules.

Self-Executed Amendment: The rule for consideration of this bill self-executes (i.e. automatically adopts) one amendment, as follows:

- Caps the amount of forgiven debt that would be eligible for tax relief under this bill at $2 million ($1 million for a married individual filing a separate tax return) and prevents the tax relief from applying to discharges of debt on account of "any other factor not directly related to a decline in the value of the residence or to the financial condition of the taxpayer."

Additional Background: A bill excluding mortgage debt income from gross income for tax purposes was introduced in the 109th Congress (H.R. 3458) by Rep. Bob Andrews (D-NJ) and Rep. Mark Foley (R-FL).

Committee Action: On September 25, 2007, the bill was referred to the Ways & Means Committee, which, on the next day, marked up and ordered the bill reported to the full House by voice vote.

Possible Conservative Concerns: Some conservatives have expressed concerns about the capital gains exclusion provision of this bill, not only because that provision yields a $2 billion tax increase over ten years, but because it could harm real estate markets that are heavily dependent on non-primary residences (such as coastal communities and retirement communities) and would target entrepreneurs who own rental properties. Some conservatives have deemed the tax increase in this bill as "a permanent luxury tax on second homes" and compare it to the failure of the luxury tax on yachts (which was repealed after harmful unintended consequences became evident).

Some conservatives have expressed particular concern at what the capital gains provision could do for retirement communities in America. As is written in the "Minority Views" section of the committee report, "the luxury tax on second homes that the majority imposes with this bill will actively discourage people from buying homes prior to their actual retirement. Rather than invest early in a retirement home and start building equity in that home, this bill will instead give people one more reason to spend their hard-earned disposable dollars on other pursuits. Luxury taxes have that effect--they push behavior away from the 'luxury' and toward other substitutes. The appreciation in these homes will no longer be 'qualified' for purposes of the exclusion from gain on a residence so instead people will choose to do other things with their money."

Democrats are portraying the second-home-owning community as the ultra-rich, but the U.S. Census Bureau estimates that one in twenty households in America owns a second home. Second homes are not just mansions on Martha's Vineyard; they are also single-room lakeside cabins, condos in senior living communities, and modest urban rambler houses. Some conservatives have expressed concerns that all of these second-home homeowners are treated the same, with the greatest burdens falling on those who are not extremely wealthy.

While there has been little opposition to the provision making debt-forgiveness income tax-free, several conservatives and the Bush Administration have expressed concerns about how the *permanent* nature of this provision would affect the housing market. As is written in the "Minority Views" section of the committee report, "…we do not know what long-term behaviors will develop in mortgage markets by the same brokers that have been offering 0% down mortgages, teaser rates, interest-only mortgages and other risky schemes to sub-prime borrowers."

Furthermore, in the past, conservatives have opposed the notion that tax cuts need to be offset—let alone with tax increases, as this legislation does. In this case, tax cuts for individuals who face foreclosure are offset with tax increases on owners of rental properties and second homes. Instead, conservatives may prefer offsets that reduce mandatory spending, not tax increases and tax-timing shifts. CBO confirms that this legislation has no implications for federal spending.

Some conservatives may also be concerned that the bill is a (small) net tax increase over ten years.

Administration Position: The Statement of Administration Policy (SAP) for H.R. 3648 notes the Administration's support for this legislation, since it helps "financially troubled homeowners by shielding mortgage write-offs from taxation." Yet the SAP also notes a concern that this tax relief should be temporary, not permanent as in the legislation. Lastly, the SAP asserts: "the Administration does not think it is necessary for this tax relief to be offset by revenue increases." Read the complete SAP here:
http://www.whitehouse.gov/omb/legislative/sap/110-1/hr3648sap-h.pdf.

Cost to Taxpayers: CBO and the Joint Committee on Taxation estimate that this legislation would reduce revenues by $179 million in FY2008, yet increase revenues by a net $151 million over the FY2008-FY2012 period and by a net $34 million over the FY2008-FY2017 period.

In other words, this bill would increase taxes by $34 million over ten years.

Does the Bill Expand the Size and Scope of the Federal Government?: No.

Does the Bill Contain Any New State-Government, Local-Government, or Private-Sector Mandates?: Yes, CBO confirms that the capital gains exclusion provision amounts to a private-sector mandate under the Unfunded Mandates Reform Act (UMRA).

Does the Bill Comply with House Rules Regarding Earmarks/Limited Tax Benefits/Limited Tariff Benefits?: The Ways & Means Committee, in House Report 110-356, asserts that, "Pursuant to clause 9 of rule XXI of the Rules of the House of Representatives, the Ways and Means Committee has determined that the bill as reported contains no congressional earmarks, limited tax benefits, or limited tariff benefits within the meaning of that rule."

Constitutional Authority: The Ways & Means Committee, in House Report 110-356, cites constitutional authority in Article I, Section 8, Clause 1 (the congressional power to lay and collect taxes) and the 16th Amendment (the congressional power to lay and collect taxes on incomes).

Outside Organizations: H.R. 3648 is supported by the National Association of Realtors, the Mortgage Bankers Association, and the National Association of Home Builders. Americans for Tax Reform is remaining neutral on the bill due to the *de minimis* size of the net income tax increase over ten years.

RSC Staff Contact: Paul S. Teller, paul.teller@mail.house.gov, (202) 226-9718